

APPENDIX G

LIHTC Compliance Monitoring Regulations

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TITLE 26--INTERNAL REVENUE

CHAPTER I--INTERNAL REVENUE SERVICE, DEPARTMENT OF THE TREASURY

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Sec. 1.42-6 Buildings qualifying for carryover allocations.

(a) Carryover allocations. A carryover allocation is an allocation that meets the requirements of section 42(h)(1)(E) or (F). If the requirements of section 42(h)(1)(E) or (F) that are required to be satisfied by the close of the calendar year are not satisfied, the allocation is treated as if it had not been made. For example, if the taxpayer's basis in the project as of the close of the calendar year of allocation is not more than 10 percent of the taxpayer's reasonably expected basis in the project as of the close of the second calendar year following the year of allocation, the carryover allocation is not valid and is treated as if it had not been made.

(b) Carryover-allocation basis--(1) In general. Subject to the limitations of paragraph (b)(2) of this section, a taxpayer's basis in a project for purposes of section 42(h)(1)(E)(ii) or (F) (carryover-allocation basis) is the taxpayer's adjusted basis in land or depreciable property that is reasonably expected to be part of the project, whether or not these amounts are includible in eligible basis under section 42(d). Thus, for example, if the project is to include property that is not residential rental property, such as commercial space, the basis attributable to the commercial space, although not includible in eligible basis, is includible in carryover-allocation basis. The adjusted basis of land and depreciable property is determined under sections 1012 and 1016, and generally includes the direct and indirect costs of acquiring, constructing, and rehabilitating the property. Costs otherwise includible in carryover-allocation basis are not excluded by reason of having been incurred prior to the calendar year in which the carryover allocation is made.

(2) Limitations--For purposes of determining carryover-allocation basis under paragraph (b)(1) of this section, the following limitations apply.

(i) Taxpayer must have basis in land or depreciable property related to the project. A taxpayer has carryover-allocation basis to the extent that it has basis in land or depreciable property and the land or depreciable property is reasonably expected to be part of the project for which the carryover allocation is made. This basis includes all items that are properly capitalizable with respect to the land or depreciable property. For example, a nonrefundable downpayment for, or an amount paid to acquire an option to purchase, land or depreciable property may be included in carryover-allocation basis if properly

capitalizable into the basis of land or depreciable property that is reasonably expected to be part of a project.

(ii) High cost areas. Any increase in eligible basis that may result under section 42(d)(5)(C) from a building's location in a qualified census tract or difficult development area is not taken into account in determining carryover-

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allocation basis or reasonably expected basis.

(iii) Amounts not treated as paid or incurred. An amount is not includible in carryover-allocation basis unless it is treated as paid or

incurred under the method of accounting used by the taxpayer. For example, a cash method taxpayer cannot include construction costs in carryover-allocation basis unless the costs have been paid, and an accrual method taxpayer cannot include construction costs in carryover-allocation basis unless they have been properly accrued. See paragraph (b)(2)(iv) of this section for a special rule for fees.

(iv) Fees. A fee is includible in carryover-allocation basis only to the extent the requirements of paragraph (b)(2)(iii) of this section are met and--

(A) The fee is reasonable;

(B) The taxpayer is legally obligated to pay the fee;

(C) The fee is capitalizable as part of the taxpayer's basis in land or depreciable property that is reasonably expected to be part of the project;

(D) The fee is not paid (or to be paid) by the taxpayer to itself; and

(E) If the fee is paid (or to be paid) by the taxpayer to a related person, and the taxpayer uses the cash method of accounting, the taxpayer could properly accrue the fee under the accrual method of accounting (considering, for example, the rules of section 461(h)). A person is a related person if the person bears a relationship to the taxpayer specified in sections 267(b) or 707(b)(1), or if the person and

the taxpayer are engaged in trades or businesses under common control (within the meaning of subsections (a) and (b) of section 52).

(3) Reasonably expected basis. Rules similar to the rules of paragraphs (a) and (b) of this section apply in determining the taxpayer's reasonably expected basis in a project (land and depreciable basis) as of the close of the second calendar year following the calendar year of the allocation.

(4) Examples. The following examples illustrate the rules of paragraphs (a) and (b) of this section.

Example 1. (i) Facts. C, an accrual-method taxpayer, receives a carryover allocation from Agency, the state housing credit agency, in September of 1993. As of that date, C has not begun construction of the low-income housing building C plans to build. However, C has owned the land on which C plans to build the building since 1985. C's basis in the land is \$100,000. C reasonably expects that by the end of 1995, C's

basis in the project of which the building is to be a part will be \$2,000,000. C also expects that because the project is located in a qualified census tract, C will be able to increase its basis in the project to \$2,600,000. Before the close of 1993, C incurs \$150,000 of costs for architects' fees and site preparation. C properly accrues these costs under its method of accounting and capitalizes the costs.

(ii) Determination of carryover-allocation basis. C's \$100,000 basis in the land is includible in carryover-allocation basis even though C has owned the land since 1985. The \$150,000 of costs C has incurred for architects' fees and site preparation are also includible in carryover-allocation basis. The expected increase in basis due to the project's location in a qualified census tract is not taken into account in determining C's carryover-allocation basis. Accordingly, C's carryover-allocation basis in the project of which the building is a part is \$250,000.

(iii) Determination of whether building is qualified. C's reasonably expected basis in the project at the close of the second calendar year following the calendar year of allocation is \$2,000,000. The expected increase in eligible basis due to the project's location in a qualified census tract is not taken into account in determining this amount. Because C's carryover-allocation basis is more than 10 percent of C's reasonably expected basis in the project of which the building is a part, the building for which C received the carryover allocation is a qualified building for purposes of section 42(h)(1)(E)(ii) and paragraph (a) of this section.

Example 2 . (i) Facts. D, an accrual-method taxpayer, receives a carryover allocation from Agency, the state housing credit agency, on September 11, 1993. As of that date, D has not begun construction of the low-income housing building D plans to build and D does not have basis in the land on which D plans to build the building. In 1993, D incurs some costs related to the planned building, including architects' fees. However, at the close of 1993, these costs do not exceed 10 percent of D's reasonably expected basis in the project.

(ii) Determination of whether building is qualified. Because D's carryover-allocation basis is not more than 10 percent of D's reasonably expected basis in the project of which the building is a part, the building for which D received a carryover allocation is not a qualified building for purposes of section 42(h)(1)(E)(ii) and paragraph (a) of this section. The carryover allocation to D is not

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valid, and is treated as if it had not been made.

(c) Verification of basis by Agency--(1) Verification requirement. An Agency that makes a carryover allocation to a taxpayer must verify that, as of the close of the calendar year of allocation, the taxpayer has incurred more than 10 percent of the reasonably expected basis in the project (land and depreciable basis).

(2) Manner of verification. An Agency may verify that a taxpayer has

incurred more than 10 percent of its reasonably expected basis in a project by obtaining a certification from the taxpayer, in writing and under penalty of perjury, that the taxpayer has incurred by the close of

the calendar year of the allocation more than 10 percent of the reasonably expected basis in the project. The certification must be accompanied by supporting documentation that the Agency must review. Supporting documentation may include, for example, copies of checks or other records of payments. Alternatively, an Agency may verify that the taxpayer has incurred adequate basis by requiring that the taxpayer obtain from an attorney or certified public accountant a written certification to the Agency, that the attorney or accountant has examined all eligible costs incurred with respect to the project and that, based upon this examination, it is the attorney's or accountant's belief that the taxpayer has incurred more than 10 percent of its reasonably expected basis in the project by the close of the calendar year of the allocation.

(3) Time of verification. An Agency may require that the basis certification be submitted to or received by the Agency prior to the close of the calendar year of allocation or within a reasonable time after the close of the calendar year of allocation. The Agency will need

to verify basis in order to accurately complete the Form 8610, 'Annual Low-Income Housing Credit Agencies Report,' for the calendar year. If certification is not timely made, or supporting documentation is lacking, inadequate, or does not actually support the certification, the

Agency should notify the taxpayer and try to get adequate documentation.

If the Agency cannot verify before the Form 8610 is filed that the taxpayer has satisfied the basis requirement for a carryover allocation,

the allocation is treated as if it had not been made and the carryover allocation document should not be filed with the Form 8610.

(d) Requirements for making carryover allocations--(1) In general. Generally, an allocation is made when an Agency issues the Form 8609, 'Low-Income Housing Credit Allocation Certification,' for a building. See Sec. 1.42-1T(d)(8)(ii). An Agency does not issue the Form 8609 for a

building until the building is placed in service. However, in cases where allocations of credit are made pursuant to section 42(h)(1)(E) (relating to carryover allocations for buildings) or section

42(h)(1)(F)

(relating to carryover allocations for multiple-building projects), Form

8609 is not used as the allocating document because the buildings are not yet in service. When an allocation is made pursuant to section 42(h)(1)(E) or (F), the allocating document is the document meeting the

requirements of paragraph (d)(2) of this section. In addition, when an allocation is made pursuant to section 42(h)(1)(F), the requirements of paragraph (d)(3) of this section must be met for the allocation to be valid. An allocation pursuant to section 42(h)(1)(E) or (F) reduces the

state housing credit ceiling for the year in which the allocation is made, whether or not the Form 8609 is also issued in that year.

(2) Requirements for allocation. An allocation pursuant to section

42(h) (1) (E) or (F) is made when an allocation document containing the following information is completed, signed, and dated by an authorized official of the Agency--

- (i) The address of each building in the project, or if none exists, a specific description of the location of each building;
- (ii) The name, address, and taxpayer identification number of the taxpayer receiving the allocation;
- (iii) The name and address of the Agency;
- (iv) The taxpayer identification number of the Agency;
- (v) The date of the allocation;

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(vi) The housing credit dollar amount allocated to the building or project, as applicable;

(vii) The taxpayer's reasonably expected basis in the project (land and depreciable basis) as of the close of the second calendar year following the calendar year in which the allocation is made;

(viii) The taxpayer's basis in the project (land and depreciable basis) as of the close of the calendar year in which the allocation is made and the percentage that basis bears to the reasonably expected basis in the project (land and depreciable basis) as of the close of the second following calendar year;

(ix) The date that each building in the project is expected to be placed in service; and

(x) The Building Identification Number (B.I.N.) to be assigned to each building in the project. The B.I.N. must reflect the year an allocation is first made to the building, regardless of the year that the building is placed in service. This B.I.N. must be used for all allocations of credit for the building. For example, rehabilitation expenditures treated as a separate new building under section **42(e)** should not have a separate B.I.N. if the building to which the rehabilitation expenditures are made has a B.I.N. In this case, the B.I.N. used for the rehabilitation expenditures shall be the B.I.N. previously assigned to the building, although the rehabilitation expenditures must have a separate Form 8609 for the allocation. Similarly, a newly constructed building that receives an allocation of credit in different calendar years must have a separate Form 8609 for each allocation. The B.I.N. assigned to the building for the first allocation must be used for the subsequent allocation.

(3) Special rules for project-based allocations--(i) In general. An allocation pursuant to section **42(h) (1) (F)** (a project-based allocation) must meet the requirements of this section as well as the requirements of section **42(h) (1) (F)**, including the minimum basis requirement of section **42(h) (1) (E) (ii)**.

(ii) Requirement of section **42(h) (1) (F) (i) (III)**. An allocation satisfies the requirement of section **42(h) (1) (F) (i) (III)** if the Form 8609 that is issued for each building that is placed in service in the project states the portion of the project-based allocation that is applied to that building.

(4) Recordkeeping requirements--(i) Taxpayer. When an allocation is made pursuant to section **42(h) (1) (E) or (F)**, the taxpayer must retain a copy of the allocation document and file an additional copy with the Form 8609 that is issued to the taxpayer for a building after the

building is placed in service. The taxpayer need only file a copy of the allocation document with the Form 8609 for the building for the first year the credit is claimed. However, the Form 8609 must be filed for the first taxable year in which the credit is claimed and for each taxable year thereafter throughout the compliance period, whether or not a credit is claimed for the taxable year.

(ii) Agency. The Agency must retain the original carryover allocation document made under paragraph (d) (2) of this section and file Schedule A (Form 8610), ``Carryover Allocation of the Low-Income Housing Credit,' with the Agency's Form 8610 for the year the allocation is made. The Agency must also retain a copy of the Form 8609 that is issued to the taxpayer and file the original with the Agency's Form 8610 that reflects the year the form is issued.

(5) Separate procedure for election of appropriate percentage month.

If a taxpayer receives an allocation under section 42(h) (1) (E) or (F) and wishes to elect under section 42(b) (2) (A) (ii) to use the appropriate percentage for a month other than the month in which a building is placed in service, the requirements specified in Sec. 1.42-8 must be met for the election to be effective.

(e) Special rules. The following rules apply for purposes of this section.

(1) Treatment of partnerships and other flow-through entities. With respect to taxpayers that own projects through partnerships or other flow-through entities (e.g., S corporations, estates, or trusts), carryover-allocation basis is determined at the entity level using the rules provided by this section. In addition, the entity is responsible for

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providing to the Agency the certification and documentation required under the basis verification requirement in paragraph (c) of this section.

(2) Transferees. If land or depreciable property that is expected to be part of a project is transferred after a carryover allocation has been made for a building that is reasonably expected to be part of the project, but before the close of the calendar year of the allocation, the transferee's carryover-allocation basis is determined under the principles of this section and section 42(d) (7). See also Rev. Rul. 91-38, 1991-2 C.B. 3 (see Sec. 601.601(d) (2) (ii) (b) of this chapter). In addition, the transferee is treated as the taxpayer for purposes of the basis verification requirement of this section, and therefore, is responsible for providing to the Agency the required certifications and documentation.

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